

Determining the Effect of Organizational Culture on Small and Medium Enterprises Performance: A SEM Approach

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Abstract

The objective of this study is to investigate the relationship of organizational culture on small and medium enterprise (SME) performance, underpinned by contingency theory, and the structural equation modelling (SEM) for data analysis. Their relationship receives a considerable scholarly attention in the literature, but few studies have been conducted among Nigerian SMEs. SMEs are considered as important to the economic growth of Nigeria and they served as the major source of employment and significantly contribute to the the gross domestic production. Based on the theoretical consideration, a model was proposed to examine this relationship. A quantitative method was used with a total of 640 questionnaires, self – administered to the owner/managers of SMEs in Nigeria. A total of 511 questions was duly completed and returned representing 79.8% response rate. The study finding is in support of previous studies who have suggested the negative relationship of organizational culture and firm performance in many organizations. The finding from this study will benefit SME owner/managers, regulatory agency ie small and medium enterprise development agency of Nigeria, it will also help in policy formulation and will serve as a frame of future reference.

1.Introduction

Strategies are aimed at gaining a competitive advantage which is discussed in the management literature. One of the most vital variables examined at a theoretical and practical dimension within such competitive strategies has been the firm performance. Interactions of variations were analyzed in various discussions and studies concerning increase in performance, which is discussed as an important conclusive variable in the literature. A common theory explaining performance is the Resource Based View (RBV) which concerned with employing resources that are unique and diversely distributed with a basic thrust of using resources that are valuable, rare, imitable and non – substitutable (Barney, 1991), and contingency theory. Cameron and Quinn (2006) saw OC as a persistent set of values, beliefs, and assumptions that described organizations and their members, while Chinloy and Mujtaba (2007), and De long and Fahey (2000) viewed organizational culture as a pattern of norms, values, beliefs and attitude that influences behaviour within an organization. Organizational culture to performance relationship produced mixed finding: The study of Berson, Oreg and Dvir (2005), Xenikuo and Simosi (2006), Ngo and Loi (2008), Noar, Goldstein and Schroeder (2008), Liu (2009), Ezirim, Nwibere and Emecheta (2010) reported significant positive relationship between organizational culture and performance, whereas, the study of Gleason et al, (2000), Lee et al, (2006), Navarro and Moya (2007) established a significant negative relationship between the study constructs. The conflicting finding on the OC – performance relationship suggest a further examination of organizational culture to small and medium enterprises performance (SME) within the Nigerian context.

Therefore, the paper is organized as follows: section two provides the review of related literature; section three is about the method including sample and procedure, measurement, goodness of measure and model testing, the next section discusses analysis and result, including hypothesis testing; section five lament on the implications for management; section six provides the limitations and direction for future studies.

2. Review of Literature

2.1 Organizational culture

Organizational culture (OC) has been defined by different scholars in different situations and contexts (Kale, 1991). According to Phatak (1989) organizational culture is defined as the way of life of a cluster of people. It is made up of knowledge, morals, belief, norms and values and any other abilities gained by one as a fellow of a given society. In other words, it is considered as the unique way of life of a group of people and their comprehensive way of life. According Lai and Lee (2007) organizational culture is seen as a collective set of values that encourages organization's values, opinion, preference and response. Hofstede (1994) defined culture as “the collective programming of the mind which differentiates the members of one group from that of another”. Culture refers to shared traditions, values, and norms (Schein, 1994). Cameron and Quinn (2006) saw OC as a persistent set of values, beliefs, and assumptions that described organizations and their members, while Chinloy and Mujtaba (2007), and De long and Fahey (2000) viewed organizational culture as a pattern of norms, values, beliefs and attitude that influences behaviour within an organization.

In addition, according to Ajmal and Koskinen (2008) organizational culture represents the basic, taken for granted assumptions and deep patterns of meaning shared by organizational participation and expressions of these assumptions. Deshpande, Jarley and Webster (1993) opined that OC guide the perception and behaviour of its members. Studies have proven that OC serves as a source of sustainable competitive advantage (Alavi *et al.*, 2006; Xenikuo & Simosi, 2006). Organizational culture is important for influencing the people and organizational thinking, behaviour, state of mind, norms and values (Shah, Iqbal, Sabir & Asif 2011). Schien (1994) provided the basic levels of culture as basic assumptions, values and artifacts respectively. The assumptions are the explanatory schemes that people use in identifying situations and making sense of on-going events, activities and human relationship which will form the basis of collective action. These assumptions have fashioned over time as members of a group develop plans to manage the problem and passing along the strategies to new peers. At the next level, values are representations of a more visible appearance of culture that shows acceptance as well as identifying what is significant to a particular group. While, the last level of culture is established through artifacts that are visible. These artifacts may include things like art, technology, language ceremony and many more.

2.2 Organizational culture and Firm performance

Several studies have been conducted in relation to organizational culture and performance and some of the findings reported significant relationship between the two constructs, others negative while there are also reported mixed findings. Berson, Oreg and Dvir (2005) investigated chief executive officers values and organizational performance of twenty six companies. The finding indicated that organizational culture is a good mediator on the relationship between CEO values and organizational performance. Xenikuo and Simosi (2006) examined transformational leadership, culture and business performance, using a sample of three hundred employees of large financial companies in Greece. The finding of the study shows that cultural orientation had a direct effect on the overall business performance.

However, Ngo and Loi (2008) reported a significant relationship between adaptability culture and human resource and marketing culture related performance of multinational firm operating in Hong Kong. Naor, Goldstein and Schroeder (2008) inspected one hundred and ninety eight manufacturing enterprises using a regression method and mail surveys. The result indicated a positive relationship between culture, infrastructure and performance. Similarly, the study of Liu (2009) assessed the relationship between organizational culture and new service delivery performance, using a face – to – face interview with one hundred and ninety two business managers. Correlation was used for data analysis, the finding reported that there are strong complementary relationships among innovative culture, supportive culture, market orientated culture, learning culture, customer communication with new service delivery performance.

The study of Eker and Eker (2009) investigated the relationship between organizational culture and performance of the Turkish manufacturing sector. A Sample of one hundred and twenty two manufacturers of the top five hundred firms was used, with logistic regression for data analysis. The finding shows that firms with flexible culture tend to be non – financial performance, while firm to control tend to use performance measurement system for monitoring. Luczak, Mohan and Hill (2010) examined national culture, market orientation and network-derived benefits for service SMEs. The findings of their study indicated culture affects business owners' market orientations. Shah *et al.*, (2011) examined the influential role of culture on leadership effectiveness and organizational performance in Pakistan. Their findings indicated a significant and positive relation between culture and performance. Similarly, Slater, Olson and Finnegan (2011) in their study of business strategy, culture, and performance used a sample of senior marketing managers with five hundred and above employee with the use of the questionnaire as a research instrument. They found that cultural orientation play a role in creating superior performance, evidencing significant and positive relationship between culture and performance.

Yazici (2011) surveyed project manager; engineers; and executive from seventy six US firms. The finding indicated that a clan or group culture facilitate a cohesive, high performing team work environment, which result in improved project and business performance. Mujeeb and Ahmad (2011) empirically tested the relationship between component of organizational culture and performance management practices, and reported significant and positive relationship between elements of organizational culture and performance management practices. Similarly, Chow (2012) examined the role of organizational culture in the human resource to performance link, used a sample of two hundred and forty three Hong Kong and Taiwanese firm operating in Guangdong, China. The finding indicated that organizational culture mediated the relationship between human resources and performance relationship. This finding is similar to Duke and Edet (2012) which surveyed ninety nine non – governmental organizational out of one hundred and thirty two operating in Nigeria. The results of ordinary least squares (OLS) reveal a positive association between organizational culture and organizational performance.

Some studies, however, reported a negative relationship between organizational culture and firm performance. Gleason, *et al.*, (2000) reported a significant negative relationship between culture, capital and

performance, when they conducted a study on the relationship between culture and performance. The data were generated from fourteen European countries using retailers, grouped into four different clusters through secondary data. Lee, Yoon, Kim and Kang (2006) investigated the effects of market-oriented culture and marketing strategy on firm performance with one hundred and twenty samples of businesses using the survey as an instrument. The data were collected using both qualitative and quantitative approaches. Regression and structural equation model were used for data analysis. The result found that MO culture does not affect firm performance. Navarro and Moya (2007) investigated learning culture using survey questionnaire and structural equation modeling. The sample collected made up of two hundred and sixty nine SMEs in two sectors that is the Spanish optometry sector and the Spanish telecommunications sector respectively. They reported a negative association between the culture of these two sectors and market orientation to performance. Additionally, Zainol (2010) examined cultural background and firm performance of Indigenous Malay family business using samples of SMEs from Kuala Lumpur and Selangor were used, with survey questionnaire and a multiple linear regression for data analysis. The finding of the study reported that EO is not a mediator of the relationship between cultural background and firm performance.

Karyeija (2012) assessed the impact of culture on performance appraisal reforms in Africa. Data was generated from one hundred and forty seven questionnaires and twenty seven interviews from Uganda's Civil Service. The finding shows a negative association between culture and performance. Similarly, Lo (2012) assessed the managerial capabilities, organizational culture and organizational performance, using resource based view as theoretical underpinning. The sample frame consists of four hundred and eleven hotels in China, structural equation modeling was used for data analysis and the study employed a survey questionnaire. The result of the study shows a negative linkage between both managerial capabilities and organizational culture on financial performance. The findings above are in agreement with each other, that organizational culture does not have any significant relationship with organizational performance. Ezirim, Nwibere and Emecheta (2010) examined the effect of organizational culture on organizational performance with regression method for data analysis. Organizational culture to performance relationship was found to be significant. Competitive, entrepreneurial and consensual organizational culture was found to be significantly positive to profitability, sales volume and market share. Bureaucratic organizational culture was negatively related to organizational performance. Based on these argument, we proposed:

H1: Organizational culture has a Positive relationship with firm performance

3. Method

3.1 Sample and Procedure

According to Small and Medium Enterprises Development Agency of Nigeria (SMEDAN, 2012), there were 1829 SMEs in Kano which constituted the population of the study. The sample size was drawn from Kriecje and Morgan (1970) table for sample size determination, based on its 320 SMEs were selected. In order to take care of none response rate and minimize error in sampling as suggested by Hair, Wolfinbarger and Ortinal (2008), the sample size was double, hence, a total of 640 questionnaires was distributed to the owner/managers of small and medium enterprises in Kano, the north- western part of Nigeria. The respondents were selected on the basis of systematic probability, random sample technique. A total of 1829 constituted the population, 640 represent the sample. Hence, based on systematic procedure the sample interval is picked by dividing the population with the sample size as (population/sample). Based on this, an interval of nth which represents 3 was chosen. Therefore, the selection process was that at starting point a value between 1 and 3 was picked, then subsequently, 6, 9 12 until the last sample picked which was the number 640 respondent. After respondent's identification through their lists, a total of 640 questionnaires was personally administered with the help of six research assistants. Some of the respondents answer the questionnaire instantly, others after some few weeks, while some took some months before their responses retrieved.

Table 1. Questionnaire Distribution and Retention

| Item | Frequency | Percentage % |
|----------------------------|-----------|--------------|
| Distributed Questionnaires | 640 | 100 |
| Returned Questionnaires | 511 | 79.8 |
| Rejected Questionnaires | 63 | 9.8 |
| Retained Questionnaires | 448 | 70 |

A total of 448 respondents constituted the sample for this research which shows a good response rate of 70 percent that covers the entire SME owner/managers in Kano, Nigeria. This rate is considered sufficient based on Sekaran's (2003) argument that a 30 percent response rate is suitable for the survey. Similarly, the current response rate is regarded adequate going with the suggestion that a sample size should be between 5 and 10 times the number of study variable for regression type of analysis to be carried (Hair *et al.*, 2010; Pallant, 2001).

Given the number of study variable 6; a sample of 60 is considered adequate for data analysis. Hence, 488 usable responses of 70 percent satisfied the required sample size required for data analysis.

3.2 Measurement

The measurements of the study were from different sources. A measurement adopted from Suliyanto and Rahab (2012) was used to measure firm performance with reliability values of 0.828 and six items. Organizational culture measurement was adopted from Al – Swidi and Mahmood (2012) with a reliability value of 0.856 and eighteen items. The firm performance and organizational culture scales were measured as uni – dimensional respectively. All variables were measured in this study using the 5- point scale, ranging from 1 (strongly disagree) to 5 (strongly agree) based on the previous works of Zhang and Fang (2000), Amin and Khan (2009), and Al – Sardia and Ahmad (2014) Shehu (2014), Shehu and Mahmood (2014a), Shehu and Mahmood (2014b).

3.3 Goodness of Measures

In this study the construct reliability is assessed by computing the composite reliability (CR) for each construct after employing the maximum likelihood estimation. Fornell and Larker (1981) criteria was used taken in the computation of CR index alongside with the reliability calculation as illustrated in Table 1. Consequently, the average variance extracted (AVE) were assessed for each construct (Anderson, 1982; Bagozzi & Lynn, 1982; Fornell & Larcker, 1981; Hair, Anderson, Tatham & Black, 1998). AVE was used to measure convergent validity (Fornell & Larcker, 1981; Hair et al., 1998) suggested convergent measures should contain less than 50 percent error variances meaning that AVE should be 0.5 or above. Hair et al., (1998; 2010) cutoff value of 0.70 and 0.50 for CR and AVE respectively was employed. The CR value ranges from 0.877 to 0.889, and the factor loadings were between 0.524 to 0.912 ($p < 0.05$), and the AVE ranged from 0.523 to 0.679 which has met the minimum threshold set (Fornell & Larcker, 1981; Hair et al., 1998). The Average variance extracted was used in this study in order to assess the convergent validity as recommended by Hair et al., (2010). The test show how the indicators of the construct converged and share the same variance. In a nutshell, the indicators are expected to converged and share a high proportion of variance on a common point, the latent constructs.

Table 1. Validity and Reliability

| Variable | Indicators | Loading | AVE | Composite Reliability |
|------------------------|------------|---------|-------|-----------------------|
| Organizational culture | OC05 | 0.602 | 0.540 | 0.889 |
| | OC06 | 0.656 | | |
| | OC07 | 0.558 | | |
| | OC08 | 0.652 | | |
| | OC16 | 0.811 | | |
| | OC17 | 0.874 | | |
| | OC18 | 0.912 | | |
| | | | | |
| Firm performance | PER01 | 0.816 | 0.617 | 0.877 |
| | PER02 | 0.954 | | |
| | PER05 | 0.524 | | |
| | PER06 | 0.571 | | |

The study also assesses the discriminant validity. Discriminant validity as the name implies, is basically concerned with the degree to which a given construct is different from other construct (Hair et al., 2010). Consequently, high level of discriminant validity shows that the latent construct is unique and captures some phenomena as against others. One of the ways of computing discriminant validity is to compare the square root of a given construct with the whole correlation of that construct, and AVE is expected to be greater than the construct correlation (Fornell & Lacker, 1981). Table 2 below indicated that all the square root of AVE ranging between 0.734 to 0.785 were greater than the value of the construct in the correlation matrix. Hence, this indicated that all constructs share more variance with their items than with other constructs, hence supporting discriminant validity.

Table 2. Discriminant Validity

| | FP | OC |
|------------------------|--------------|--------------|
| Firm performance | 0.734 | |
| Organizational culture | .025 | 0.785 |

4.6 Model Testing

The model fit was assessed using a series of indices recommended by Hair et al., (2010), Brian (2006), – the DELTA2 (Bollen, 1989), Comparative fit (CFI) (Bentler,1990), good-of-fit index (GFI), Tucker-Lewis (TLI), and the root mean square error of approximation (RMSEA) indices. A fit to the data was achieved for the GFI = 0.870 as indicated in table 3.

Table 3. Fit indices for the Measurement Model

| Fit Indexes | Expected | Achieved Values | Sources |
|------------------|----------|-----------------|-------------------------------------|
| DF | | 189.314 | |
| X^2 | | 0.000 | |
| Bollen – stine P | <0.05 | 5.916 | |
| X^2/df | | 0.870 | Hair et al (2010), Brain (2006). |
| GFI | >0.90 | 0.801 | |
| AGFI | >0.90 | 0.841 | |
| CFI | >0.90 | 0.128 | |
| RMSEA | < 0.08 | 0.797 | |
| TLI | >0.95 | | |

4. Analysis and Result

The present study employed a structural equation modeling (SEM), which is aimed at investigating the relationship between implicit variables mentioned in the theory, by removing manipulation in relations between variables, eliminates measurement errors and presents researchers with accurate and more refined results when compared to other techniques. This technique becomes real, especially in the simultaneous explanation of a series of related variables in managerial and behavioural matters (Cheng, 2001). The most fundamental feature of SEM studies is that they are fully based on theory and able to check specific hypotheses relationship. Structural equation modelling (SEM) was performed using the maximum likelihood method to test the hypotheses. This procedure permitted an assessment of the reliability of the measures, as well as an assessment of the degree to which the observed relations among variables fitted the hypothesized network of causal relationships, as shown in Figure 1. One of the techniques which used in SEM studies is parceling. Bandalos and Finney (2001) mentioned that among the most frequently confronted situations concerning the reasons for use of the item parceling comes the number of variables on the scale and insufficiency of the number of universal units (Holt, 2004). Kline (1998) expresses that, if sample is <100, a small-scaled volume is referred to and a limited number of analyses are permitted; if te sample is 100-200, a midscale volume is referred to, if sample is >200, a large-scaled volume is referred to and thus, more meaningful results can be achieved as the number of samples increases. Again, it is mentioned in research studies related to this scale that if the ratio of sample volume of the number of items is 5:1, statistically suspicious. Therefore, a sample of 448 which represent 70 percent is regarded as a good sample for the conduct of structural equation modelling (SEM) technique of data analysis.

Figure 1. Measurement Model

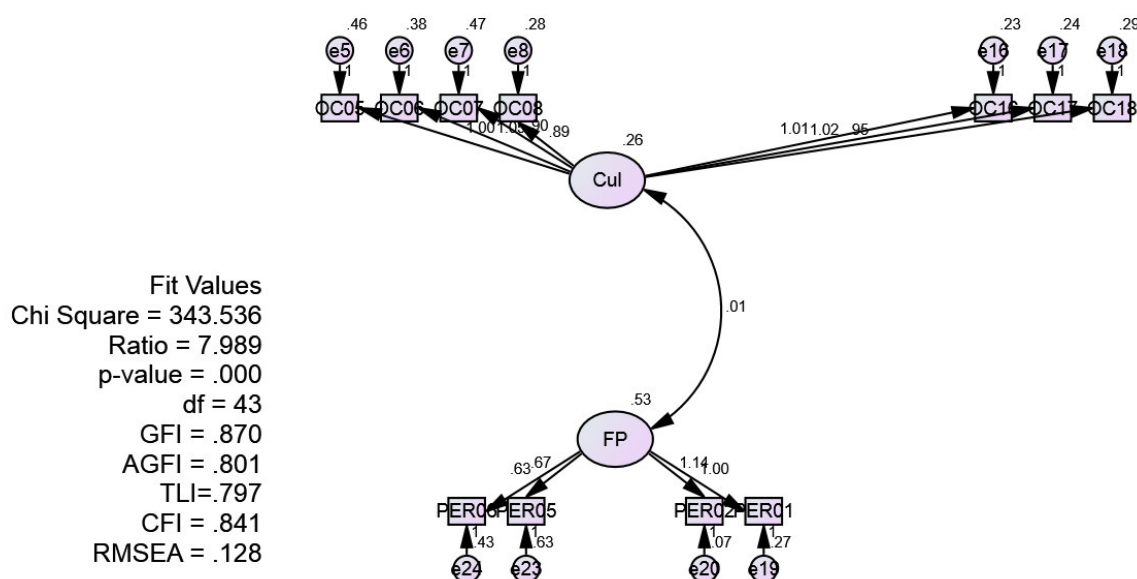
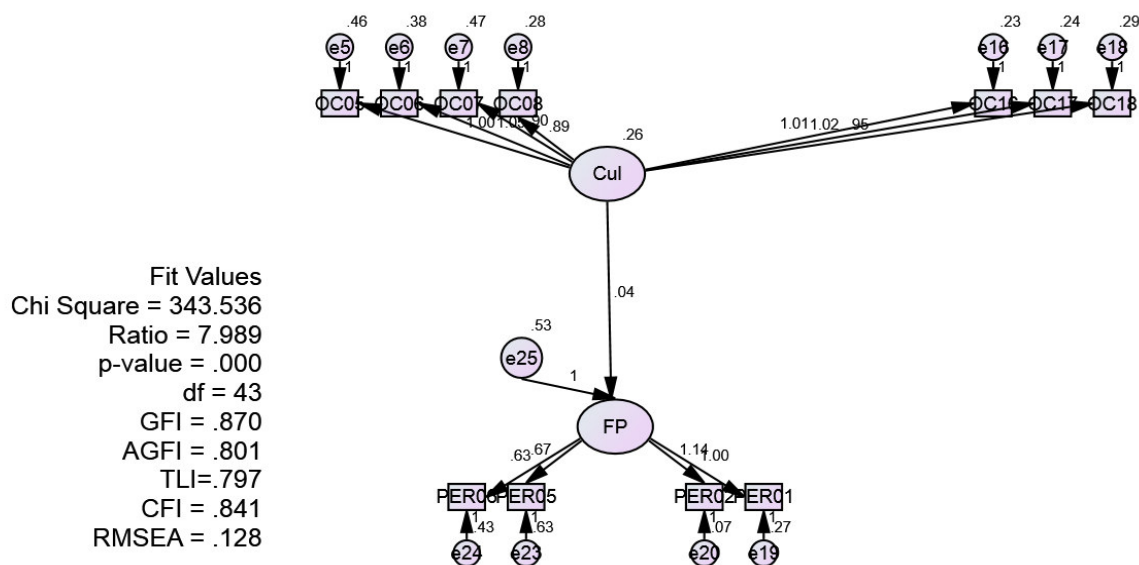


Figure 2: Structural Model



4.1 Hypotheses Test

Hypothesis test was carried using a structural Equation Modelling (SEM) of which the result is listed in the table 4. Based on the result of the table, it shows the path coefficient variable of market orientation to business performance CR is .454 at 95 percent confidence level. Thus, the first hypothesis is rejected evidencing that organizational culture does not have any relationship with firm performance of Nigerian SMEs. Therefore, H1 is not supported.

The result supported the previous findings of Gleason, *et al.*, (2000) reported a significant negative relationship between culture, capital and performance, when they conducted a study on the relationship between culture and performance. The data were generated from fourteen European countries using retailers, grouped into four different clusters through secondary data. Lee, Yoon, Kim and Kang (2006) investigated the effects of market-oriented culture and marketing strategy on firm performance with one hundred and twenty samples of businesses using the survey as an instrument. The data were collected using both qualitative and quantitative approaches. Regression and structural equation model were used for data analysis. The result found that market oriented culture does not affect firm performance.

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Table 3. Hypothesis Testing

| | Estimate | S.E | C.R | P | Decision |
|-----------|----------|------|------|------|---------------|
| FP<--- OC | .036 | .079 | .454 | .650 | Not supported |

5. Implication for Management

The finding from the present study will benefit SME owner/managers for them to have a sound understanding of the direct relationship between organizational culture and firm performance of Nigerian SMEs. Small and medium enterprise development agency of Nigeria (SMEDAN) which is the regulator of SME activities in Nigeria can use the finding in policy and other curriculum development in the future entrepreneurship programs. Various arms of government, such as the local, state and federal government stand a chance of using the present study for them to have a good understanding of SME performance in relation to the effect of organizational culture. Additionally, this study serves as a frame of future research.

6. Limitations and Direction for Future Research

The study has some methodological shortcomings. First, the study is cross sectional in nature, hence, the data was only collected at a point in time, and the direct effect of the independent variable on dependent variable is difficult to conclude. Secondly, the data from the study was collected from the owner/managers of randomly selected SMEs in Kano, other region and states were not included, hence, the impossibility of generalization. Other variable and other factor were not considered in the present study.

Future studies should focus on specific industry such as manufacturing, service, agriculture, education, health and social works, hotels and restaurant and so on. Additionally, a qualitative method is suggested for an in-depth understanding of organizational culture and firm performance relationship with any suitable moderating and mediating variable. Longitudinal study is also suggested for future research, with a data that will cover a wider geographical area. The use of other statistical tools on strategic orientation to performance relationship is recommended such as smart PLS, SPSS (regression analysis).

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